

China reflation momentum strengthens in April, likely keeping the PBOC on hold

Both China's CPI and PPI inflation beat forecasts in April, with producer prices and non-food costs hitting 45-month highs. Yet the full economic impact of higher energy prices is likely yet to be seen



The People's Bank of China (PBoC) building in Beijing, China

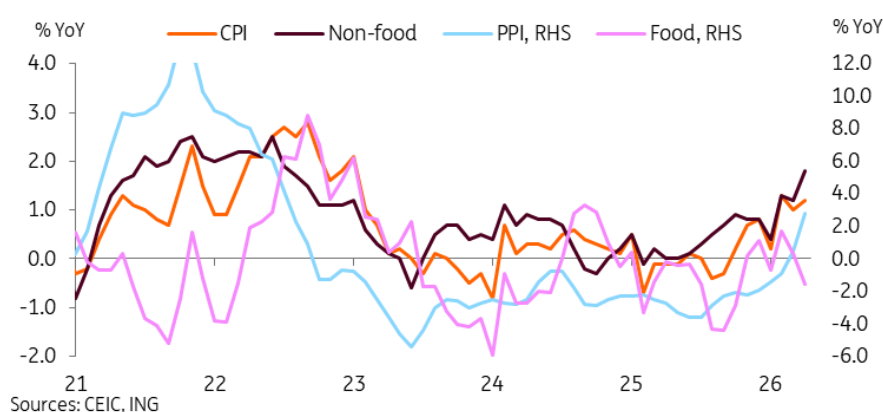
2.8% YoY

China's April PPI inflation

45-month high

Higher than expected

PPI and non-food inflation both reached 45-month highs



CPI inflation rebounds in April despite drag from food prices

China's CPI inflation rose to 1.2% year-on-year in April, up from 1.0% in March, bucking market forecasts for a slight drop on the month. Through the first four months of the year, CPI inflation is now up 0.9% YoY.

The impact of higher energy prices stemming from the Iran war was clear in the data. We saw a 17.4% YoY surge in energy for the transportation subcategory, which rose 11.5% month-on-month after a 10% spike in last month's data. China's gasoline prices have risen by less than crude oil prices since the start of the Iran War, suggesting that there's still likely upside ahead for this subcategory if oil prices stay elevated.

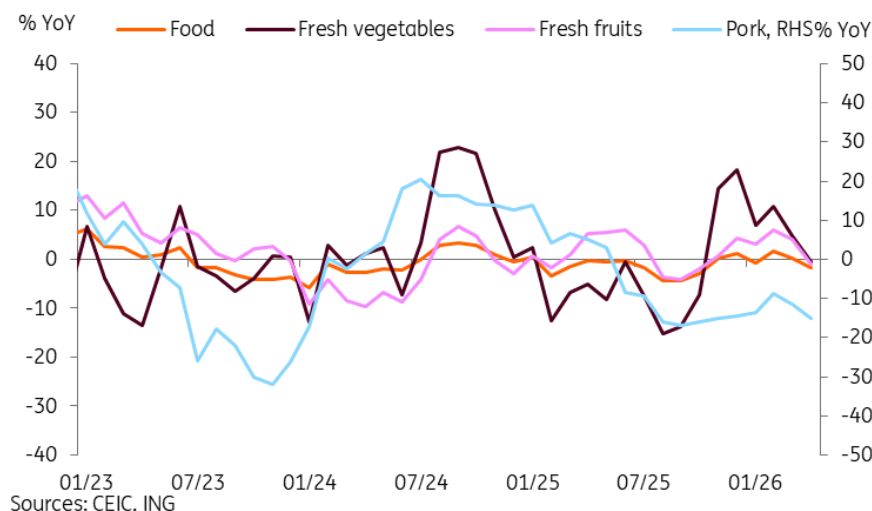
However, the reflation story is not just about energy. Core inflation rose 1.2% YoY in April, in line with the headline inflation rate.

The non-food inflation (1.8%) categories generally showed signs of reflation as well. The Clothing (1.5%) and daily-use goods (1.4%) categories both remained well within positive inflation territory.

A key exception was the residential rents subindex, which fell -0.6% YoY. Though we've seen a few months of housing price data showing a smaller decline, the continued fall in rents suggests that pressure remains on the property sector.

Food inflation was a drag on inflation in April, down -1.6% YoY. Most food categories were in negative YoY inflation, with pork prices (-15.2%) in particular causing a surprisingly large drag. We expect this drag to fade in the coming months, though China's typical pork cycle could be affected by ongoing deals to buy soybeans, leading to oversupply. With soybeans as a key input for pig feed, excess supply could potentially keep pork prices suppressed longer than normal.

Food inflation still dragging inflation amid pork price weakness



PPI inflation hits 45-month high

PPI inflation also surprised on the upside in April, rising to 2.8% YoY, up from 0.5% in March. This marks the ninth consecutive month in which PPI inflation has picked up YoY, and the second straight month of positive PPI inflation.

Unsurprisingly, the PPI inflation subcategories showed a strong impact of higher energy prices. Oil and gas extraction industries (28.6%), petroleum, coal and other fuel processing industries (14.2%), and non-ferrous metals industries (38.9%) joined the industries seeing the highest inflation.

In general, raw materials prices rose 7.1% YoY in April, while fuel and power prices for producers also picked up to 4.4% YoY. Assuming we do not see a timely fall in energy prices, these higher input costs for producers will likely feed through the broader economy in the coming months, fuelling the reflation narrative but also beginning to drag on growth.

Reflation and resilience of exports further reduces rate cut urgency

We saw in the weekend data that China's trade growth beat expectations again in April, with both exports and imports surpassing market forecasts. External demand has been one of the primary drivers of growth in China over the past several years. This trend appears to be continuing this year, with the next few months expected to benefit from a rebound in exports to the US. Domestic activity generally looks quite soft by comparison. But even with consumption and investment lagging, China still managed 5.0% YoY growth in the first quarter.

This start to the year, combined with the recent reflation momentum, will likely keep the People's Bank of China on pause for now. Unlike many central banks globally, China's next move remains more likely to be a cut than a hike. It looks increasingly likely that such a move won't happen until at least the second half of the year, barring a significantly sharper-than-expected deterioration in activity data ahead.

Author

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

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